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IN THE
Supreme Court of the United States

OCTOBER TERM, 1941

NO. 1176

L. W. MESTA, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI.

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INDEX.

	PAGE
Opinions Below	1
Jurisdiction	2
Question Presented	2
Summary Statement of the Matter Involved.....	2
Specification of Errors to Be Urged.....	5
Reasons Relied on for the Allowance of the Writ...	6
Appendix	13

Cases Cited.

Commissioner v. Bennett B. Bristol, 121 F. (2d) 129	9
Commissioner v. A. Crawford Greene, 119 F. (2d) 383; cer. den. U. S., 86 L. Ed. 76.....	10
Eisner v. Macomber, 252 U. S. 189, 207.....	11
Halliwell, Walter S., v. Commissioner, 44 B. T. A. 640	7, 8
Harrison v. Schaffner, 312 U. S. 579.....	12
Helvering v. American Chicle Co., 291 U. S. 426....	11
Helvering v. Fitch, 309 U. S. 141.....	12
Helvering v. Horst, 311 U. S. 112.....	12
Helvering v. United States Trust Company et al., 111 F. (2d) 576, cer. den. 61 S. Ct. 45.....	10
Helvering v. Wilshire Oil Company, Inc., 306 U. S. 628	7
Kalman Hirsch v. Commissioner, 115 F. (2d) 656...	11
Pearce v. Commissioner, U. S., decided March 9, 1942, 86 L. Ed. 675.....	12
United States v. Kirby Lumber Company, 284 U. S. 1	11

Index.

Statutes and Authorities.

	PAGE
Revenue Act of 1926, c. 27, 44 Stat. 9, Sec. 303 (d) . . .	9
Revenue Act of 1932, c. 209, 47 Stat. 169, Sec. 804 . . .	10
Regulations 86, Art. 22 (b) (3)	10
Illustrative Cases Bulletin 6, 1941 CCH, Par. 0104D	8
University of Pennsylvania Law Review, Vol. 90, No. 5, March 1942, p. 628	9

APPENDIX.

Statutes and Regulations.

INCOME TAX.

Revenue Act of 1934, c. 277, 48 Stat. 680, (U. S. C., Title 26) ; Sec. 22,	13
Sec. 111	14
Sec. 112	14
Sec. 117	14
Regulations 86, Revenue Act of 1934, Art. 22 (b) (3)	15

GIFT TAX.

Revenue Act of 1932, c. 209, 47 Stat. 169, Sec. 804, Sec. 501 (a) and (b) ; Sec. 503	15
Regulations 79, Art. 1 and Art 8	16

ESTATE TAX.

Revenue Act of 1926, c. 27, 44 Stat. 9, Sec. 303 (d) . .	17
Regulations 80, Art. 15; Art. 23	17

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**COMMISSIONER OF INTERNAL REVENUE,
Respondent.**

PETITION FOR WRIT OF CERTIORARI.

*To the Honorable, the Chief Justice and
Associate Justices of the United States:*

L. W. Mesta, petitioner above named, respectfully prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Third Circuit entered in the above entitled cause on November 25, 1941, reversing by divided opinion the decision of the Board of Tax Appeals.

Opinions Below.

The opinion of the Board of Tax Appeals (R. 3-14) is reported in 42 B. T. A. 933. The opinion of the Circuit Court of Appeals (R. 32-36) is reported in 123 F. (2d) 986.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered November 25, 1941 (R. 37). The time within which to file this petition was extended to April 25, 1942, by order of this Court entered February 11, 1942 (R. 38). The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925.

Question Presented.

Whether the delivery of corporate stock by a husband to his divorced wife pursuant to an agreement signed by the wife after the divorce hearing but prior to decree is a transaction from which income is realized by the husband, or is a taxable gift, or is a nontaxable division of property between husband and wife where all marital obligations of the husband are discharged by the divorce decree.

Summary Statement of the Matter Involved.

The facts were stipulated and briefly are as follows:

Petitioner, an individual residing at Pittsburgh, Pennsylvania, duly filed his Federal Income tax return for the calendar year 1935 with the Collector of Internal Revenue for the Twenty-third Collection District of Pennsylvania. (R. 17)

Petitioner and his former wife, Cora Jane Mesta, were married August 19, 1921, and lived together until they separated on October 12, 1934. No issue resulted from the marriage. (R. 17)

On February 14, 1935, Cora Jane Mesta filed a libel in divorce in the Court of Common Pleas of Allegheny

County, Pennsylvania, praying for a decree divorcing her and petitioner "from bed and board." On March 5, 1935, petitioner filed a rule for a bill of particulars and on March 19, 1935, a bill of particulars was filed by said Cora Jane Mesta. On March 20, 1935, petitioner filed an answer to said bill of particulars. On March 8, 1935, the prayer of the libel was changed at the request of libellant to a prayer for a decree "from the bonds of matrimony." A hearing was had on the divorce action on April 12, 1935, and on April 15, 1935, a final decree was entered by which petitioner and his former wife were "divorced and separated from the bonds of matrimony." (R. 18)

Under the terms of an agreement signed by petitioner on March 22, 1935, and by his former wife on April 13, 1935, petitioner agreed to deliver to his former wife 5200 shares of the common stock of Mesta Machine Company, a diamond ring, a Cadillac automobile, a set of golf clubs, a golf bag, all household furnishings in their home, and agreed to give up any claim he might have against her property or estate by reason of the marriage relationship; and his former wife agreed that the home which was owned by them as tenants by the entireties should vest in petitioner and that the property transferred to her should be in complete satisfaction of all claims on her part for support and in lieu of all rights she might have or acquire against the property or estate of petitioner by reason of the relationship of husband and wife (R. 18-19; Ex. E, R. 22-26).

On April 17, 1935, petitioner, in accordance with the terms of the aforesaid agreement, delivered to his former wife the 5200 shares of Mesta Machine Company common and on April 25, 1935, deeds for the purpose of vesting in petitioner title to the home were recorded. The fair market value of 5200 shares of Mesta Machine

Company common on April 17, 1935, was \$156,975 and the cost or base to petitioner of the 5200 shares transferred to his former wife was \$7,574.56 (R. 19).

As of April 13, 1935, petitioner was possessed of an estate in personalty of approximately \$1,150,000 and the value of the real estate owned by petitioner and his wife was approximately \$35,000. The household furnishings had a value of \$28,000 and his former wife claimed them and the other miscellaneous property mentioned in the agreement as her own property. (R. 19)

On April 17, 1935, petitioner was 45 years of age and his wife was 57 years of age. The present worth of \$1.00 payable to a woman now aged 57 at the death of her husband now aged 45, assuming she outlives him, is 0.187. (R. 19)

On or about March 9, 1936, petitioner filed a gift tax return, reporting thereon a gift of 5200 shares of Mesta Machine Company common to his former wife and paid gift tax in the amount of \$3,346.13. (R. 20)

On or about November 26, 1937, petitioner filed a protective claim for refund of gift tax paid as aforesaid on the ground that if the transaction was held to be a sale no gift was involved, and on or about December 21, 1938, a certificate of overassessment for the gift tax paid for both the years 1936 and 1937 and interest thereon was issued in the amount of \$7,837.64. On or about March 31, 1939, the Collector at Pittsburgh gave to petitioner a check issued by the Treasurer of the United States for the amount of the overassessment and interest. Counsel for petitioner advised the Collector on March 2, 1939, that this proceeding was pending in the Board of Tax Appeals and that acceptance of the check should in no way prejudice petitioner's rights in this

proceeding and this position was reiterated when counsel for petitioner wrote the Collector on or about April 1, 1939, acknowledging receipt of the check. (R. 20-21, Exs. G, I and K, R. 27-30) ¹

Respondent determined that petitioner had realized capital gain in the amount of \$149,400.44, being the difference between his cost of \$7,574.56 and the fair market value of the stock (\$156,975.00) on the date of transfer, and determined a deficiency in tax of \$31,163.18.

The Board of Tax Appeals reversed the respondent and determined that no gain had been realized by petitioner by virtue of the transaction. (R. 3-14)

The Circuit Court of Appeals, having first heard argument before a three-judge court and then, on its own motion, before a five-judge court, reversed the Board with two Judges dissenting. (R. 32-36)

Specification of Errors to Be Urged.

The Circuit Court of Appeals erred:

1. In holding that the transfer of stock from the husband to his divorced wife resulted in the realization of taxable income.
2. In holding that the wife surrendered property having an ascertainable value.
3. In holding that the transfer of stock from husband to his divorced wife was not a gift.
4. In holding that the transfer of stock from husband to his divorced wife was not a marriage settlement.

1. Refund for 1937 resulted from application of the general exemption not used in 1936 as a result of the 1936 refund.

5. In holding that the transfer of stock from husband to his divorced wife was not a division of property.

6. In failing and refusing to hold that all obligations of the husband to his wife had been discharged by the divorce decree.

7. In failing and refusing to hold that the transfer of the stock did not satisfy any obligation of the husband.

8. In reversing the decision of the Board of Tax Appeals.

Reasons Relied on for the Allowance of the Writ.

1. The case presents an important question of federal law involving the construction and administration of the federal income and gift tax acts, which should be settled by an authoritative decision of this Court. It involves the basic and far-reaching question whether transactions of this character result in the realization of taxable income, or in the making of a taxable gift, or in a non-taxable division of property between husband and wife. The Board of Tax Appeals held that the transaction was a non-taxable division of property. The Circuit Court of Appeals held that the transaction created an income tax liability on the husband.

The question was considered sufficiently important to merit review by a five-judge court and was sufficiently doubtful to result in a dissent by two judges of that court on the basis of the opinion of the Board of Tax Appeals.

If the decision of the Circuit Court of Appeals is allowed to stand it means

(a) that money settlements made by a husband on his wife, *irrespective of divorce or separation*, in consideration of a release by the wife of her statutory rights and of his obligation to support her, will not be subject to gift tax. Men may so arrange their affairs that all future transactions of this character may be consummated by money payments rather than by transfers of property, thus eliminating both gift and income taxes on the transaction—a loophole of great magnitude is created, not closed;

(b) that, if followed to its logical conclusion, the wife exchanged her inchoate property rights having no cost or other base to her for stock having a fair market value of \$156,975, from which exchange she would realize a taxable gain of \$156,975—an astounding proposition, but a logical result; and

(c) that the husband by transferring high cost stock, after divorce, could take a capital loss.

Petitioner is advised that the Gift Tax Unit of the Bureau of Internal Revenue is now closing transactions of this character by the imposition of a gift tax and that at the same time the Income Tax Unit of the same Bureau, is imposing an income tax liability in other but similar cases.

The question is now pending in the Circuit Court of Appeals for the Second Circuit in the case of *Walter S. Halliwell*, 44 B. T. A. 640.² There the Board in a fifteen to one report followed the decision in the instant case. Petition for review was filed by the Commission prior to the decision of the court below in the instant

2. Cf. *Petitions for Writ of Certiorari in Helvering v. Wilshire Oil Company, Inc.*, No. 163 October Term, 1938, filed June, 1938, No. 1 October Term, 1939, filed March, 1939, granted April 3, 1939, 306 U. S. 628.

case. On January 28, 1942, subsequent to the decision of the court below in the instant case, the Commissioner filed a second motion to extend the time within which to complete and transmit the record in the *Hallinwell* case on the ground that it would appear undesirable to prepare a record on review pending the final outcome of the *Mesta* case, thus recognizing that an authoritative decision by this court was desirable.

The importance of the question is further emphasized by the following statement in the opinion of the Board of Tax Appeals:

"To hold that a man has realized taxable income by giving up a substantial portion of his property seems to us unreasonable and not justified either under general law or under the Revenue Act."

It is further emphasized by the editors of Commerce Clearing House in Illustrative Cases Bulletin 6, 1941 CCH, Par. 0104D:

"In principle, a property settlement arrangement of this kind should not be held to constitute such a closed transaction as will require the husband to account for a more or less mythical gain, as measured by the assumed excess valuation of the rights surrendered by the wife (a valuation extremely difficult to arrive at and apt to be of a largely hypothetical character) as compared with the basis of the property transferred in satisfaction of such rights. The idea that there may be gain to account for under such circumstances has its origin in the conception that what takes place is an *exchange* between husband and wife of property rights. However it would appear that this conception is not actually in accord with the true nature of the transaction and that what really occurs is not an *exchange* but rather a *severance* or *division*

of the respective property rights of the spouses, akin, in principle (though different in the technical legal sense), to a partition of property by tenants in common."

Compare article in University of Pennsylvania Law Review Vol. 90, No. 5, March 1942, p. 628.

2. The decision of the court below is in conflict in principle with the decision of the Circuit Court of Appeals for the First Circuit in *Commissioner v. Bennett B. Bristol*, 121 F. (2d) 129. In that case the husband, pursuant to an ante-nuptial contract, purchased two annuities for his wife and transferred two pieces of realty to himself and her as tenants by the entireties. In return, she relinquished all her statutory rights in certain stock owned by him. The Circuit Court of Appeals, reversing the Board, held that the wife's release of her statutory rights was not adequate and full consideration in money or money's worth; that the estate and gift tax acts were in *pari materia*; that the 1932 amendment to Section 303(d) of the Revenue Act of 1926 providing that release of dower, statutory or other marital rights "shall not be considered to any extent a consideration in money or money's worth" furnished the basis for the same definition with respect to the gift tax act; that the rights surrendered by the wife were incapable of valuation; and that the transfer by the husband to the wife was subject to a gift tax.

In the instant case, the court below held without any discussion of the *Bristol* case: "Obviously the transfer was not a gift or a marriage settlement as contended by the respondent",³ and that the value of the stock was the measure of the rights surrendered by the wife.

3. The *Bristol* case was decided by the Board on June 28, 1940, 42 B. T. A. 263. The *Mesta* case was decided October 10, 1940, and the Commissioner, in February 1941, advised petitioner's counsel that in his opinion the decisions were conflicting. Both decisions were reversed by the Circuit Courts of Appeals and the conflict still continues.

3. The decision of the court below is likewise in conflict in principle with the decision of the Circuit Court of Appeals for the Second Circuit in *Helvering v. United States Trust Company et al.*, 111 F. (2d) 576, cer. den. 61 S. Ct. 45. In that case the husband made an agreement with his wife a few months prior to a divorce which provided for payments to her of \$2,500 a month during her life, out of which she was to support herself and maintain a daughter during the time that the daughter resided with her. Pursuant to one of the terms of the agreement, the decedent, six months later, exercised an option to discharge his obligations by setting up a trust. The wife was given power to appoint approximately fifty per cent of the trust by will. The court held that the wife's right of support was a marital right within the meaning of Section 804 of the Revenue Act of 1932 and therefore there was no consideration in money or money's worth for the transfer of the corpus from the husband to the trustee except to the extent of the value at decedent's death of the obligation of the wife to support the child. It follows that if the wife's right to support is a marital right, the settlement thereof is a marriage settlement, contrary to the opinion of the lower court in the instant case. (Reg. 86, Art. 22 (b) (3), Appendix)

4. The decision of the court below is likewise in conflict in principle with the decision of the Circuit Court of Appeals for the Ninth Circuit in *Commissioner v. A. Crawford Greene*, 119 F. (2d) 383; certiorari denied October 13, 1941, . . . , U. S. . . . , 86 L. Ed. 76. In that case a California probate court had ordered the estate of an incompetent to make certain payments for the maintenance and support of the incompetent's two adult daughters who were incapable of maintaining themselves by work. The court held that the discharge of the legal obligation imposed by the California law

was not "consideration" within the meaning of the gift tax act and therefore the payments for support constituted taxable gifts. In the instant case the court below made the assumption that one who spends money or gives property of a fixed value for an unliquidated claim is getting his money's worth (consideration).

5. The decision of the court below is in conflict in principle with the decision of the Circuit Court of Appeals for the Seventh Circuit in *Kalman Hirsch v. Commissioner*, 115 F. (2d) 656. In that case the court held that a solvent mortgagor did not realize income by paying off a mortgage for less than the full debt because he received nothing of exchangeable value. The court said:

"A transaction whereby nothing of exchangeable value comes to or is received by the taxpayer does not give rise to, or create, taxable income. *Eisner v. Macomber*, 252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521, 9 A.L.R. 1570; *Reuben v. Commissioner*, 8 Cir., 97 F. 2d 926."

The petitioner's situation differs from that in the debt-discharge cases such as *United States v. Kirby Lumber Company*, 284 U. S. 1, and *Helvering v. American Chicle Co.*, 291 U.S. 426, since in those cases the taxpayer had originally received money or something of exchangeable value at the time of the creation of the debt. Here, assuming that an obligation was discharged by the transfer of the stock although, by law, his obligations were discharged by the divorce decree, this petitioner never received anything from his divorced wife of exchangeable value—nothing for his separate use, benefit and disposal. The decision in holding that he has received income is contrary to the definition of income announced in *Eisner v. Macomber*, 252 U.S. 189, 207, which has been frequently cited and followed. The question whether

that definition should now be limited and narrowed in scope is an important question which merits review by this Court.

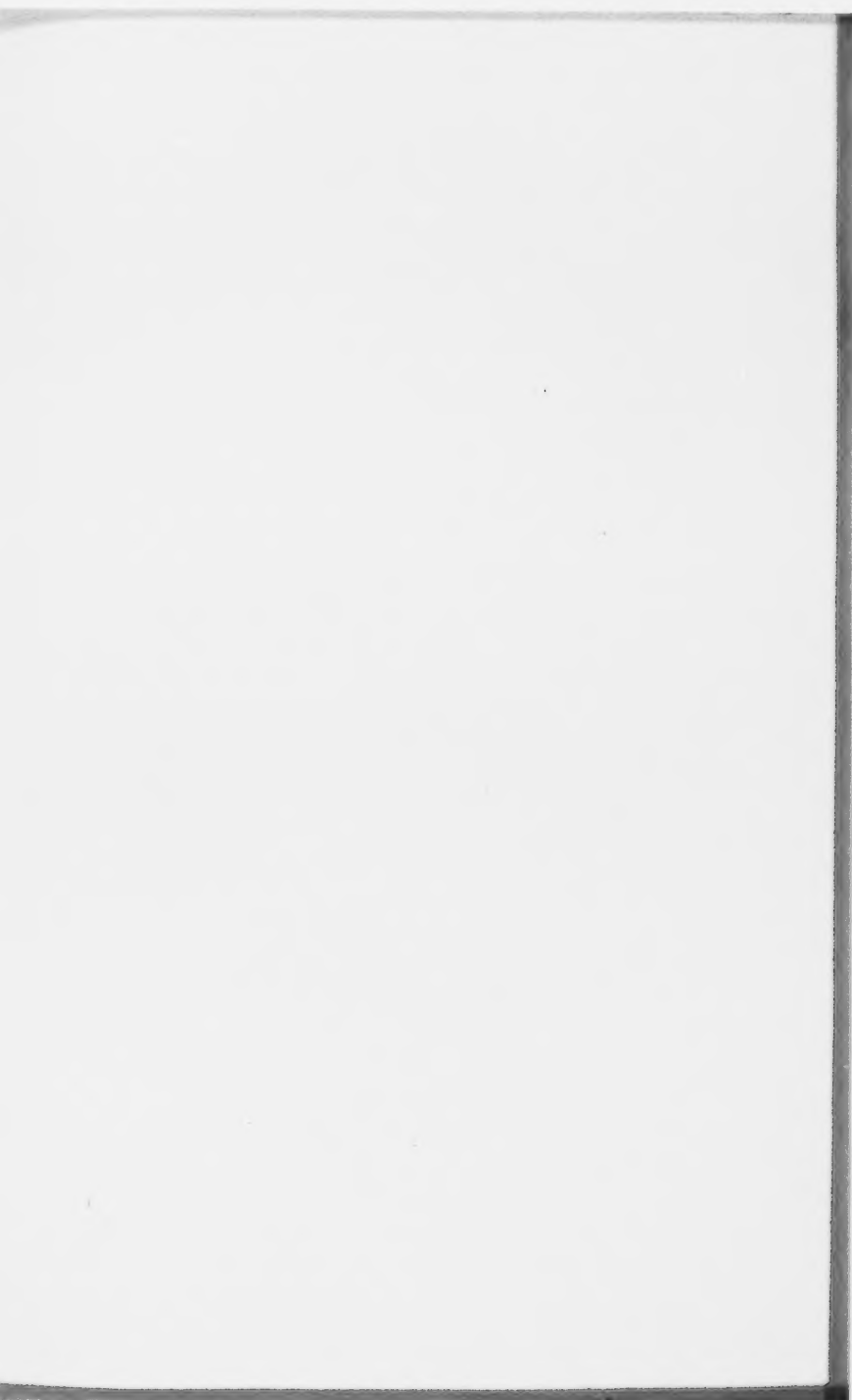
6. The court below has applied the rule of *Helvering v. Horst*, 311 U. S. 112, involving a transfer of accrued income, to this case, involving a transfer of income-producing property, contrary to the expressed reservation of the question in *Harrison v. Schaffner*, 312 U. S. 579 and to the distinction pointed out in *Josephine S. Pearce v. Commissioner*, . . . U. S. . . ., decided March 9, 1942, 86 L. Ed. 675.⁴ The question whether the rule of *Helvering v. Horst* should be so extended is an important question which, having been reserved by this Court, now merits review.

Respectfully submitted,

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4. In the Pearce case certiorari was granted because of the manner in which the lower court applied the rule of *Helvering v. Fitch*, 309 U. S. 141.





APPENDIX.

Statutes and Regulations.

Income Tax.

Revenue Act of 1934, c. 277, 48 Stat. 680, (U. S. C., Title 26) :

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes *gains, profits, and income* derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or *gains or profits and income* derived from any source whatever. * * *

(b) *Exclusions from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this title:

* * * * *

(3) *Gifts, Bequests, and Devises.*—The value of property acquired by gift, bequest, devise, or inheritance (but the income from such property shall be included in gross income);

* * * * *

(e) *Determination of Gain or Loss.*—In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in section 111.

* * * * *

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113(b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) *Amount Realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

* * * * *

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

* * * * *

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *General Rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 1 year;

80 per centum if the capital asset has been held for more than 1 year but not for more than 2 years;

60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years;

40 per centum if the capital asset has been

held for more than 5 years but not for more than 10 years;

30 per centum if the capital asset has been held for more than 10 years.

* * * * *

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 22(b) (3)—1. *Gifts and bequests.*—Property received as a gift, or received under a will or under statutes of descent and distribution, is exempt from the income tax, although the income therefrom derived from investment, sale, or otherwise is not. An amount of principal paid under a marriage settlement is a gift. Neither alimony nor an allowance based on a separation agreement is taxable income.

Gift Tax.

Revenue Act of 1932, c. 209, 47 Stat. 169, Section 501 (a) and (b); Section 503:

"Section 501. Imposition of Tax.

"(a) For the calendar year 1932 and each calendar year thereafter a tax, computed as provided in section 502, shall be imposed upon the transfer during such calendar year by any individual, resident or nonresident, of property by gift.

"(b) The tax shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible; but, in the case of a nonresident not a citizen of the United States, shall apply to a transfer only if the property is situated within the United States. The tax shall not apply to a transfer made on or before the date of the enactment of this Act."

"Sec. 503. Transfer for less than adequate and full consideration.

"Where property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall, for the purpose of the tax imposed by this title, be deemed a gift, and shall be included in computing the amount of gifts made during the calendar year."

Regulations 79 relating to gift tax:

"Article 1. Imposition of tax.—The statute imposes no tax upon property, but subjects to tax transfers of property by gift. The tax is not limited in its imposition to transfers of property without a valuable consideration, which at common law are treated as gifts, but extends to sales and exchanges for less than an adequate and full consideration in money or money's worth. (See article 8.)"

"Art. 8. Transfers for a consideration in money or money's worth.—Transfers reached by the statute are not confined to those only which, being without a valuable consideration, accord with the common law concept of gifts, but embrace as well sales, exchanges, and other dispositions of property for a consideration in money or money's worth to the extent that the value of the property transferred by the donor exceeds the value of the consideration given therefor. However, a sale, exchange, or other transfer of property made in the ordinary course of business (a transaction which is bona fide, at arm's length, and free from any donative intent), will be considered as made for an adequate and full consideration in money or money's worth. A consideration not reducible to a money value, as love and affection, promise of marriage, etc., is to be wholly disregarded, and the entire value of the property transferred constitutes the amount of the gift."

Estate Tax.

Revenue Act of 1926, C. 27, 44 Stat. 9, Sec. 303 (d) as amended by Sec. 804 of the Revenue Act of 1932, and now carried forward as Sec. 812 (b) of the Internal Revenue Code.

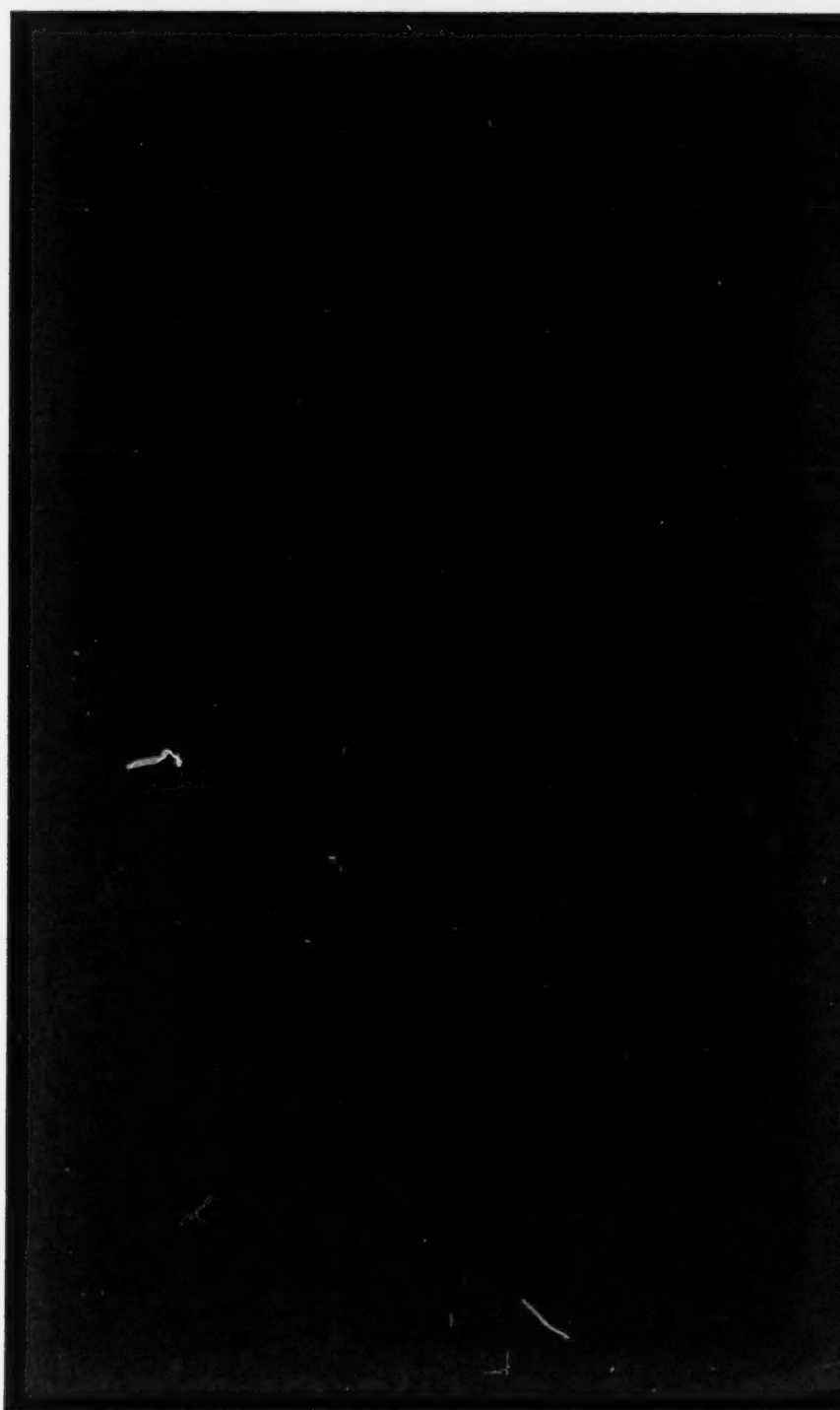
"* * * For the purposes of this title, a relinquishment or promised relinquishment of dower, curtesy, or of a statutory estate created in lieu of dower or curtesy, or of other marital rights in the decedent's property or estate, shall not be considered to any extent a consideration in 'money or money's worth.'"

Regulations 80 (1937 edition, Estate Tax) Art. 15:

"* * * For the purposes of the estate tax a relinquishment or promised relinquishment of dower, curtesy, or of a statutory estate created in lieu of dower or curtesy, or of other marital rights in the decedent's property or estate, is not to any extent a consideration in money or money's worth."

Art. 23:

"For the purposes of the estate tax, a relinquishment or promised relinquishment of dower, curtesy, or of a statutory estate created in lieu of dower or curtesy, or of other marital rights in the decedent's property or estate, is not to any extent a consideration in money or money's worth."



INDEX

	Page
Opinions below.....	1
Jurisdiction.....	1
Question presented.....	2
Statutes and regulations involved.....	2
Statement.....	2
Argument.....	4
Conclusion.....	10
Appendix.....	11

CITATIONS

Cases:

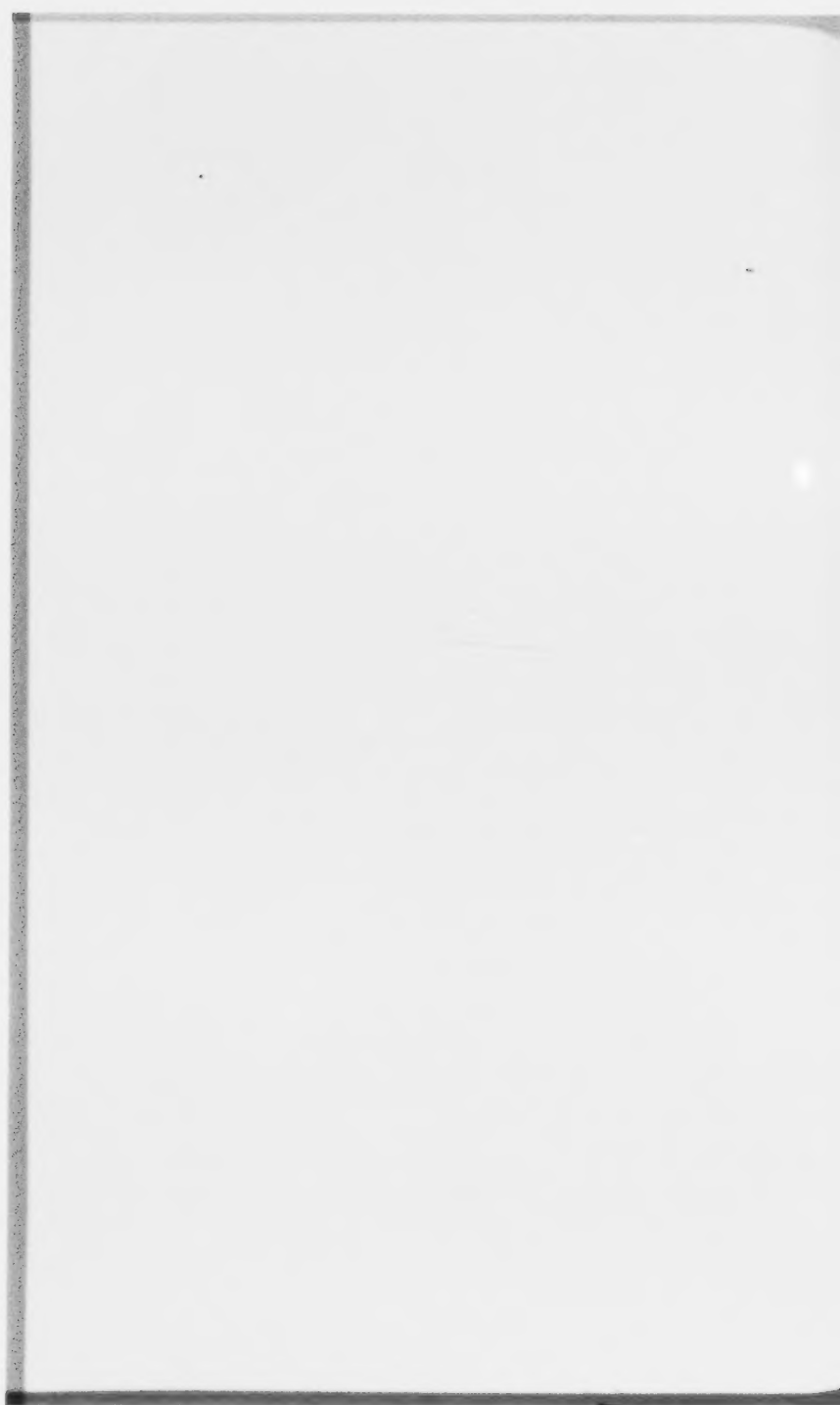
<i>Bowers v. Kerbaugh-Empire Co.</i> , 271 U. S. 170.....	9
<i>Commissioner v. Bristol</i> , 121 F. (2d) 129.....	6, 7
<i>Commissioner v. Greene</i> , 119 F. (2d) 383, certiorari denied, 314 U. S. 641.....	6, 8
<i>Dixon v. Commissioner</i> , 109 F. (2d) 984.....	4
<i>Ewing, Sherman</i> , 40 B. T. A. 912.....	5
<i>Glendinning v. Commissioner</i> , 97 F. (2d) 51.....	4
<i>Halliwel, Walter S.</i> , 44 B. T. A. 740.....	7
<i>Harrison v. Schaffner</i> , 312 U. S. 579.....	9
<i>Helvering v. Fuller</i> , 310 U. S. 69.....	5
<i>Helvering v. Horst</i> , 311 U. S. 112.....	9
<i>Helvering v. United States Trust Co.</i> , 111 F. (2d) 576, cer- tiorari denied, 311 U. S. 678.....	6, 7
<i>Hirsch v. Commissioner</i> , 115 F. (2d) 656.....	8
<i>Kenan v. Commissioner</i> , 114 F. (2d) 217.....	5
<i>Moore v. Moore</i> , 64 Pa. Super. 192.....	4
<i>Suisman v. Eaton</i> , 15 F. Supp. 113, affirmed <i>per curiam</i> , 83 F. (2d) 1019, certiorari denied, 299 U. S. 573.....	5, 9
<i>United States v. Kirby Lumber Co.</i> , 284 U. S. 1.....	5

Statutes:

Revenue Act of 1934, c. 277, 48 Stat. 680:	
Sec. 22.....	11
Sec. 111.....	11
Sec. 112.....	12
Sec. 117.....	12
Pennsylvania Statutes Annotated (Purdon, 1930), title 23:	
Sec. 45.....	4, 13
Sec. 46.....	4, 13
Sec. 47.....	4, 14

Miscellaneous:

Bouvier, Law Dictionary (1897) 320.....	7
Treasury Regulations 86, Art. 22 (b) (3)-1.....	7, 13



In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 1176

L. W. MESTA, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL
REVENUE

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE THIRD
CIRCUIT*

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 3-14) is reported in 42 B. T. A. 933. The opinion of the Circuit Court of Appeals (R. 32-36) is reported in 123 F. (2d) 986.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered November 25, 1941 (R. 37). The time within which to file a petition for a writ of certiorari was extended to April 25, 1942, by order of

this Court entered February 11, 1942 (R. 38). The petition for a writ of certiorari was filed April 25, 1942. Jurisdiction of this Court is invoked under section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether petitioner realized income by the transfer of stock to his wife, pursuant to an agreement made in anticipation of divorce, when the stock had a market value at the time of the transfer in excess of its basis in the hands of petitioner.

STATUTES AND REGULATIONS INVOLVED

The relevant statutory provisions and regulations are set forth in the Appendix, *infra*, pp. 11-14.

STATEMENT

The facts may be summarized as follows from the stipulation of the parties before the Board:

On February 14, 1935, petitioner's wife, Cora Jane Mesta, filed a libel of divorce against petitioner in the Court of Common Pleas of Allegheny County, Pennsylvania, praying for a divorce from bed and board and for alimony. On March 8, 1935, Mrs. Mesta amended her libel to ask for an absolute divorce (R. 18). On March 22, 1935, petitioner signed an agreement providing for the transfer to his wife of 5,200 shares of common stock of the Mesta Machine Company together with dividends on the stock declared or paid after March 6, 1935

(R. 18, 22, Ex. E). The agreement further provided that both petitioner and Mrs. Mesta waived any claims or rights either might have against the other's property or estate growing out of the relationship of husband and wife, and that the property to be conveyed to Mrs. Mesta was in full satisfaction of all her claims for maintenance and support (R. 23, Ex. E). This agreement was then delivered to Mrs. Mesta's attorney and was signed by her on April 13, 1935 (R. 18). On April 15, 1935, the state court entered a decree granting her an absolute divorce from petitioner (R. 18). On April 17, 1935, the stock was transferred to Mrs. Mesta (R. 19). The 5,200 shares had a fair market value on that date of \$156,975; their cost to petitioner had been \$7,574.56 (R. 19).

Petitioner filed a gift-tax return and paid a tax upon the transfer of the stock (R. 20). Subsequently he filed a claim for refund, and the gift tax paid was refunded to him, with interest (R. 20, 27, Ex. G). Petitioner advised the collector of internal revenue to whom he had paid the tax that he accepted the refund without prejudice to his rights in the present proceeding, which was then pending before the Board of Tax Appeals (R. 20, 28, Ex. I, R. 30, Ex. K). The Commissioner determined that petitioner in 1935 had realized a capital gain of \$149,400.44, the difference between the cost of the stock and its fair market value at the time of transfer; accordingly, he determined

a deficiency in income tax of \$31,163.18 (R. 3). This determination was reversed by the Board of Tax Appeals, which held that no gain had been realized (R. 15). The decision of the Board was reversed by the Circuit Court of Appeals¹ (R. 37).

ARGUMENT

1. When petitioner transferred the 5,200 shares of Mesta Machine Company stock to his wife on April 17, 1935, he was discharging the obligation of his agreement with Mrs. Mesta made four days earlier. While under the law of Pennsylvania permanent alimony may be awarded only in the case of a divorce from bed and board,² an agreement providing for the support of a wife after absolute divorce will be enforced. See *Glendinning v. Commissioner*, 97 F. (2d) 51 (C. C. A. 3). In discharging his obligation to Mrs. Mesta, petitioner disposed of property which had a basis in his hands much lower than the value of the property when transferred. Since the parties were dealing at arm's length in making the agreement, it can only be supposed that Mrs. Mesta was relinquishing her rights in return for the contemporary value of the

¹ Two judges dissented. The case was first argued before three judges; the court on its own motion ordered a reargument before all five judges *en banc*.

² *Moore v. Moore*, 64 Pa. Super. 192; see Pa. Stat. Ann. (Purdon, 1930), title 23, secs. 46, 47; *Dixon v. Commissioner*, 109 F. (2d) 984, 986 (C. C. A. 3). An exception is made in the case of absolute divorce where the respondent is insane; permanent alimony may then be awarded. Pa. Stat. Ann. (Purdon, 1930), title 23, sec. 45.

stock as income-producing property.³ As the court below stated (R. 36), the practical assumption is warranted "that a man who spends money or gives property of a fixed value for an unliquidated claim is getting his money's worth."⁴ Accordingly, petitioner satisfied a contractual obligation owed to his wife with stock which had cost him much less than the amount of the claim being extinguished, and he realized gain to the extent of the difference. *Suisman v. Eaton*, 15 F. Supp. 113 (D. Conn.), affirmed *per curiam*, 83 F. (2d) 1019 (C. C. A. 2), certiorari denied, 299 U. S. 573; *Keenan v. Commissioner*, 114 F. (2d) 217 (C. C. A. 2); cf. *United States v. Kirby Lumber Co.*, 284 U. S. 1.⁵

³ While it is true that Mrs. Mesta's amendment of her libel, asking an absolute rather than a limited divorce, antedated the agreement with petitioner, the amendment clearly should not be regarded as unrelated to the agreement, since the wife would be financially protected under the state law in case of absolute divorce only by virtue of an extra-judicial settlement (see page 4, *supra*); with such a settlement in prospect, she could safely amend the libel. See R. 34 (opinion below).

Mrs. Mesta's basis for the stock on her disposition of it would be its fair market value at the time of acquisition in April 1935. Cf. *Sherman Ewing*, 40 B. T. A. 912.

⁴ The soundness of this proposition in the particular case is reflected in the stipulation of the parties (R. 19) that petitioner on April 13, 1935, owned personal property worth approximately \$1,150,000.

⁵ As this Court has stated, the transfer of stock outright by a husband to his wife as part of a property settlement in divorce does not differ from the situation "where any debtor * * * transfers securities * * * to his creditor in whole or partial payment of his debt." *Helvering v. Fuller*, 310 U. S. 69, 74.

2. There is no conflict of decisions, since no other circuit court of appeals or the Court of Claims has passed on the question involved in the present case.⁶ Petitioner does not contend otherwise, but alleges (Pet. 9-10) "conflict in principle" between the decision below and *Helvering v. United States Trust Co.*, 111 F. (2d) 576 (C. C. A. 2), certiorari denied, 311 U. S. 678; *Commissioner v. Greene*, 119 F. (2d) 383 (C. C. A. 9), certiorari denied, 314 U. S. 641; and *Commissioner v. Bristol*, 121 F. (2d) 129 (C. C. A. 1). In the *United States Trust Co.* case the court held that a wife's surrender of her right to support in return for her husband's creating a trust fund for her pursuant to an agreement made prior to divorce was a "relinquishment * * * of * * * marital rights in the decedent's property or estate" within the meaning of section 804 of the Revenue Act of 1932, so that the transfer in trust was not for a consideration "in money or money's worth" under another section, exempting from estate tax. In the *Bristol* case a comparable *antenuptial* transfer, in return for surrender of the wife's statutory rights in other property owned by the husband, was held subject to gift tax as not having been made for a consideration "in money or money's worth" by analogy to the estate-

⁶ The same question has been raised in *Walter S. Halliwell*, 44 B. T. A. 740, now pending on appeal to the Circuit Court of Appeals for the Second Circuit. The Board there followed its decision herein.

tax law. Petitioner has contended that his transfer to Mrs. Mesta in 1935 was a marriage settlement under Article 22 (b) (3)-1 of Regulations 86 and therefore constituted a gift (C. C. A. Br. 20-21); the court below stated the contrary (R. 36), and petitioner alleges that the decision therefore conflicts in principle with the holdings that surrender of marital rights is not full and adequate consideration in money or money's worth.

Argument is unnecessary that the transfer was not a marriage settlement, for purposes of the income tax. See 2 Bouvier, Law Dictionary (1897) 320. Further, none of the cases cited by petitioner as conflicting hold that a divorce settlement (made in consideration of a surrender of the right to support) is a gift, for purposes of the gift tax law.⁷ Such a result may be implicit in the *United States Trust Co.* and *Bristol* cases, taken together, but it

⁷ Petitioner states (Pet. 7) "that the Gift Tax Unit of the Bureau of Internal Revenue is now closing transactions of this character by the imposition of a gift tax and that at the same time the Income Tax Unit of the same Bureau, is imposing an income tax liability in other but similar cases." The Bureau of Internal Revenue has advised that the Miscellaneous Tax Unit, which administers the gift tax, has taken the position that divorce settlements do not effect gifts to the extent that the settlements are made in satisfaction of an obligation to support spouse and children. However, the Unit rules that relinquishment of dower or statutory rights in lieu of dower is not full and adequate consideration in money or money's worth, and property transferred in return for such relinquishment is held taxable as a gift.

would clearly not exclude the imposition of income tax on the transferor where he realizes gain from the disposition of property in discharging an obligation. The gift and income taxes are separate legislation; Congress may well have provided that a transaction which happens to give rise to income under one law results in transfer-tax liability under the other pursuant to an exemption provision which excludes transfers for less than full pecuniary consideration (such as surrender of the right to support). *Commissioner v. Greene, supra*, cited by petitioner as conflicting, merely holds that money paid from the estate of an incompetent, pursuant to the distribution order of a probate court, for support of the incompetent's adult daughters is subject to gift tax because of lack of consideration for the transfer. It is plain from what has been said above that the decision of the court below, on income tax, presents no conflict with any of the three cases advanced by petitioner, involving other taxes.

3. Petitioner also contends that he realized no gain in the transfer to Mrs. Mesta because he received nothing of exchangeable value in return.*

* *Hirsch v. Commissioner*, 115 F. (2d) 656 (C. C. A. 7), is cited in the petition as conflicting (Pet. 11). The opinion there contains a statement supporting petitioner (115 F. (2d) at 657), but the holding is not in point. A purchaser had arranged to acquire real estate for a cash payment and the

Obviously such receipt is unnecessary. *Suisman v. Eaton, supra*; *Kenan v. Commissioner, supra*; cf. *Helvering v. Horst*, 311 U. S. 112. In support of its decision the court below quoted (R. 35) a statement from the opinion in the *Horst* case: "Where the taxpayer does not receive payment of income in money or property realization may occur when the last step is taken by which he obtains the fruition of the economic gain which has already accrued to him" (311 U. S. at 115).

Petitioner states that the Circuit Court of Appeals has extended the rule of *Helvering v. Horst, supra*, to the case of a transfer of income-producing property, and asserts that since the question of the outer extent of the rule's applicability was reserved by the Court in *Harrison v. Schaffner*, 312 U. S. 579, 583-584, the decision below should be reviewed (Pet. 12). The argument would have merit only if the Commissioner had attempted to tax the dividends received by petitioner's wife on the Mesta Machine Company stock after the transfer.

assumption of a mortgage; after the property had declined greatly in value, the purchaser secured a release from the mortgage debt by payment of less than its face amount. The court held that the purchaser had not realized gain, that the release constituted only a reduction in purchase price, and that its income-tax consequences should not be assessed until the taxpayer disposed of the real estate, when the economic result of the whole transaction would be known. Cf. *Bowers v. Kerbaugh-Empire Co.*, 271 U. S. 170.

CONCLUSION

The judgment below is correct, and presents no conflict of decisions. It is therefore respectfully submitted that the petition should be denied.

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MAY 1942.



APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 22. GROSS INCOME.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(b) *Exclusions from gross income.*—The following items shall not be included in gross income and shall be exempt from taxation under this title:

* * * * *

(3) *Gifts, bequests, and devises.*—The value of property acquired by gift, bequest, devise, or inheritance (but the income from such property shall be included in gross income);

* * * * *

(e) *Determination of gain or loss.*—In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in section 111.

* * * * *

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of gain or loss.*—The gain from the sale or other disposition of

property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) *Amount realized*.—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

* * * * *

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule*.—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

* * * * *

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *General rule*.—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 1 year;

80 per centum if the capital asset has been held for more than 1 year but not for more than 2 years;

60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years;

40 per centum if the capital asset has been held for more than 5 years but not for more than 10 years;

30 per centum if the capital asset has been held for more than 10 years.

* * * * *

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 22 (b) (3)-1. *Gifts and bequests.*—Property received as a gift, or received under a will or under statutes of descent and distribution, is exempt from the income tax, although the income therefrom derived from investment, sale, or otherwise is not. An amount of principal paid under a marriage settlement is a gift. Neither alimony nor an allowance based on a separation agreement is taxable income.

Pennsylvania Statutes Annotated (Purdon, 1930), title 23:

SEC. 45. *Permanent alimony where respondent insane.*

In case of the application of a husband for divorce from an insane wife, the court, or the judge thereof to whom the application is made, shall have power to decree alimony for the support of such insane wife during the term of her natural life, by requiring the libellant to file a bond, with surety or sureties if necessary, in such sum as he or it may direct, conditioned as aforesaid, before granting the divorce.

If the wife be the petitioner, and have sufficient means, the court, or the judge, may provide for the support of the insane husband, as provided in this section for an insane wife, if the insane husband has not sufficient estate in his own right for his support. (1929, May 2, P. L. 1237, sec. 45.)

SEC. 46. *Alimony pendente lite, counsel fees and expenses.*—In case of divorce from the bonds of matrimony or bed and board, the court may, upon petition, in proper cases, allow a wife reasonable alimony pendente lite and reasonable counsel fees and

expenses. (1929, May 2, P. L. 1237, sec. 46, as amended, 1933, May 25, P. L. 1020, sec. 1.)

SEC. 47. *Alimony in divorce from bed and board.*

Allowance; continuance; suspension, annulment, revival and enforcement of decree.—In cases of divorce from bed and board, the court may allow the wife such alimony as her husband's circumstances will admit of, but the same shall not exceed the third part of the annual profit or income of his estate, or of his occupation and labor, which allowance shall continue until a reconciliation shall take place, or until the husband shall, by his petition or libel, offer to receive and cohabit with her again and to use her as a good husband ought to do; and then in such case the court may either suspend the aforesaid decree, or, in case of her refusal to return and cohabit under the protection of the court, discharge and annul the same according to its discretion; and, if he fail in performing his said offers and engagements, the former sentence or decree may be revived and enforced, and the arrears of the alimony ordered to be paid.
* * * (1929, May 2, P. L. 1237, sec. 47.)

